

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 08-07**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether a limited partnership owned in part by a grantor trust qualifies as an exempt family-owned noncorporate entity for purposes of Tennessee franchise and excise taxation.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[TAXPAYER] is a limited partnership with headquarters in [STATE – NOT TENNESSEE]. The Taxpayer owns real estate in [TENNESSEE AND OTHER STATES]. The Taxpayer derives 100 percent of its income from rental real estate activities.

The partners of the [TAXPAYER] are as follows:

[NAME 1]	1.00%
[NAME 2]	1.00%
[NAME - TRUST]	1.00%
[NAME – LIMITED PARTNERSHIP]	97.00%

The partners of [LIMITED PARTNERSHIP] are as follows:

[NAME 1]	1.00%
[NAME 2]	1.00%
[TRUST] (as general partner)	1.00%
[TRUST] (as limited partner)	97.00%

The [TRUST] is a grantor type trust wholly owned by [NAME 3], the father of [NAME 1 AND NAME 2].

QUESTION

Is the Taxpayer exempt as a family-owned noncorporate entity for purposes of Tennessee franchise and excise taxation?

RULING

No.

ANALYSIS

The Taxpayer is not exempt as a family-owned noncorporate entity for purposes of Tennessee franchise and excise taxation because the Taxpayer does not qualify as a “family-owned” entity.

Tennessee imposes an excise tax at the rate of 6.5 percent on the net earnings of all persons doing business within Tennessee. Tenn. Code Ann. § 67-4-2007(a) (2007). Additionally, Tennessee imposes a franchise tax on all persons doing business within Tennessee, at the rate of \$0.25 per \$100, or major fraction thereof, of a taxpayer’s net worth. Tenn. Code Ann. §§ 67-4-2105(a) (2007) and 67-4-2106(a) (2007). Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, limited partnerships. Tenn. Code Ann. § 67-4-2004(30) (2007).

Tenn. Code Ann. § 67-4-2008(a)(11)(A) (2007) exempts from the Tennessee excise tax any “family-owned noncorporate entity,” where substantially all the activity of the entity is the production of passive investment income. In addition, Tenn. Code Ann. § 67-4-2105(a) (2007) provides an exemption from the Tennessee franchise tax for any entity exempt from the excise tax under the provisions of Tenn. Code Ann. § 67-4-2008. Tenn. Code Ann. § 67-4-2008(a)(11)(B)(i) (2007) provides that “‘family-owned’ means that at least ninety-five percent (95%) of the ownership units of the entity are owned by members of the family, which means, with respect to an individual, *only*:” (a) an ancestor of such individual; (b) the spouse or former

spouse of such individual; (c) a lineal descendent of such individual, of such individual's spouse or former spouse, or of a parent of such individual; (d) the spouse or former spouse of any such lineal descendent; or (e) the estate or trust of a deceased individual who, while living, was one of the types of individuals described herein. (Emphasis added.)

Thus, to qualify for the family-owned noncorporate entity exemption under Tenn. Code Ann. § 67-4-2008(a)(11), partners in the Taxpayer who qualify as “members of the family” must own at least 95 percent of the ownership units of the Taxpayer. [NAME 1 AND NAME 2], the two individuals who are partners in the Taxpayer, are both the lineal descendants of one individual, [NAME 3], and thus qualify as “members of the family” under Tenn. Code Ann. § 67-4-2008(a)(11)(B)(i)(c). The third partner, the [TRUST], is a trust owned by [NAME 3], an individual who qualifies as a member of the family; however, [NAME 3] is not deceased. As a result, the [TRUST] does not come within the definition of “members of the family” under Tenn. Code Ann. § 67-4-2008(a)(11)(B)(i). The fourth partner, [LIMITED PARTNERSHIP], is a limited partnership, and likewise does not come within the definition of “members of the family.” Accordingly, only two partners in the Taxpayer qualify as members of the family; these two partners collectively own just two percent of the ownership units in the Taxpayer. Because members of the family own less than 95 percent of the ownership units in the Taxpayer, the Taxpayer does not qualify as a “family-owned” entity.

Note that while the Taxpayer is ultimately owned by three individuals who come within the definition of “members of the family,”¹ [NAME 3'S] indirect ownership of the Taxpayer through the [TRUST] and [LIMITED PARTNERSHIP], cannot be taken into account in the determination of whether the Taxpayer is “family-owned” under Tenn. Code Ann. § 67-4-2008(a)(11)(B)(i). As noted above, Tenn. Code Ann. § 67-4-2008(a)(11)(B)(i) provides that the term “family-owned” means that “at least ninety-five percent (95%) of the ownership units of the entity *are owned by* members of the family.” (Emphasis added.) [NAME 3] does not own units in the Taxpayer; rather, he owns an interest in a trust that owns an interest in a partnership that owns an interest in the Taxpayer. To treat [NAME 3] as a “member of the family” in the absence of actual ownership of units in the Taxpayer would impermissibly extend the meaning of the statute beyond its plain language. The Tennessee Supreme Court has stated that legislative intent is to be ascertained whenever possible “without forced or subtle construction that would limit or extend the meaning of the language.” *Boarman v. Jaynes*, 109 S.W.3d 286, 290-291 (Tenn. 2003). Similarly, the Tennessee Court of Appeals has stated that courts must give effect to the “plain import of the language of the act.” *Saturn Corp. v. Johnson*, 197 S.W.3d 273, 276 (Tenn.Ct.App. 2006) (citing *International Harvester Co. v. Carr*, 466 S.W.2d 207, 214 (Tenn. 1971)).

Additionally, the burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that “[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that ‘exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.’” *American Airlines, Inc. v. Johnson*, 56 S.W.3d 502,

¹ All three are the lineal descendants of one individual, i.e., the parent of [NAME 3] and the grandparent of [NAME 1 AND NAME 2].

506 (Tenn.Ct.App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn.Ct.App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *American Airlines, Inc. v. Johnson*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)). [NAME 3'S] lack of actual ownership of units in the Taxpayer raises sufficient doubt so as to defeat a claimed exemption from the Tennessee franchise and excise taxes.

Accordingly, the Taxpayer is not exempt for purposes of Tennessee franchise and excise taxation pursuant to Tenn. Code Ann. § 67-4-2008(a)(11) (2007).

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APPROVED: Reagan Farr
Commissioner of Revenue

DATE: 02/20/08